

## INDEX

	Page
Opinion Below .....	1
Jurisdiction .....	2
Questions Presented .....	2
Statement .....	3
Specification of Error.....	6
Reasons for Granting the Writ.....	6

## TABLE OF AUTHORITIES

Cases:	Page
Bane v. Pritchett, 223 Ill. App. 617.....	9, 10
Bearss v. Ford, 108 Ill. 16.....	8, 9
Belleville Savings Bank v. Reis, 136 Ill. 242, 26 N. E. 646.....	7
Brine v. Hartford Fire Insurance Company, 96 U. S. 627, 24 L. Ed. 858.....	12
Brockway v. McClun, 243 Ill. 196, 90 N. E. 374.....	12
Coney v. Winchell, 116 U. S. 227, 29 L. Ed. 610.....	12
Erie R. Co. v. Tompkins, 304 U. S. 69, 82 L. Ed. 1118 .....	13
Forthman v. Deters, 206 Ill. 159, 69 N. E. 97.....	8, 11
Kazunas v. Wright, 286 Ill. App. 554, 4 N. E. 2d 118 .....	13
Kelly v. Lehman, 297 Ill. 33, 130 N. E. 375.....	9, 10
Kessler v. Aller, 287 Ill. App. 606, 5 N. E. 2d 761....	7
Kulik v. Kapusta, 303 Ill. 208, 135 N. E. 402.....	9, 10
Lillie v. McFarlin, 304 Ill. App. 27, 25 N. E. 2d 896	13
Lyman v. Gedney, 114 Ill. 388, 29 N. E. 282.....	10
Novak v. Kruse, 288 Ill. 363, 123 N. E. 519.....	9
Palmer v. Hoffman, 87 L. Ed. 427 (advance sheet)	14
Paxton Realty Company v. Peaker, 212 Ind. 480, 9 N. E. 2d 96.....	13, 14

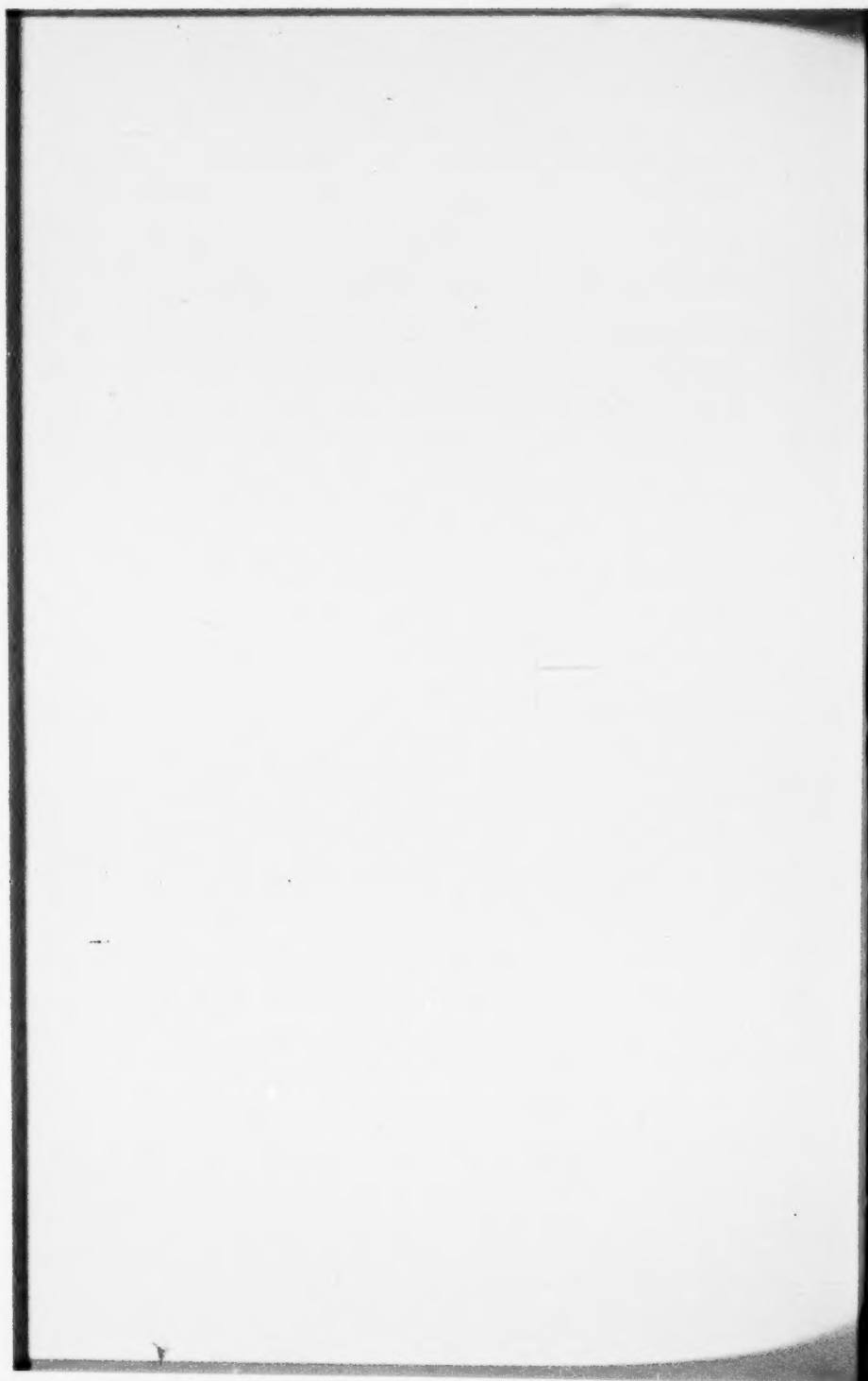
Railroad etc. Assn. v. United States, 135 F. (2d) 290 .....	11, 12
Shinn v. Frederick, 56 Ill. 439.....	10
State v. Traylor, 77 Ind. App. 419, 132 N. E. 608....	14
Swift v. Smith, 102 U. S. 442, 26 L. Ed. 193.....	12
Tabero v. Stutekowski, 286 Ill. App. 225, 3 N. E. 2d 115.....	10
Weiner v. Heinz, 17 Ill. 259.....	7, 10
Williams v. Griffith, 310 Ill. App. 574, 35 N. E. 2d 95 .....	9, 13
Woodward v. McCollum, 16 N. Dak. 42, 111 N. W. 623 .....	12

Statute:

Illinois Stat. Ch. 77, Sec. 18.....	12
L. 1879, p. 211; ch. 95, Sec. 23, Ill. Rev. St.....	7
53 Stat. 425, as amended, c. 247, Title I, sec. 1, 53 Stat. 862.....	11
Judicial Code, Sec. 240(a), 28 U. S. C. A. Sec. 347(a) .....	2
26 U. S. C. A. sec. 3482.....	11

Text:

37 Am. Jur. Sec. 829, p. 215.....	12
41 Am. Jur. Sec. 118, p. 371.....	15
3 Jones on Mortgages, 8 ed. sec. 1582, p. 16.....	12



IN THE  
**SUPREME COURT OF THE UNITED STATES**

OCTOBER TERM, 1943

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JOSEPH WILLIAM LETOURNEAU  
and MARCELLENE F. LETOURNEAU,  
*Petitioners,*

v.

COMMERCIAL MERCHANTS NATIONAL  
BANK AND TRUST COMPANY OF  
PEORIA, a corporation,

*Respondent.*

No. \_\_\_\_\_

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**PETITION FOR WRIT OF CERTIORARI TO THE  
UNITED STATES CIRCUIT COURT OF APPEALS  
FOR THE SEVENTH CIRCUIT**

Petitioners, Joseph William LeTourneau and Marcellene F. LeTourneau, pray that a writ of certiorari be issued to review the judgment herein of the United States Circuit Court of Appeals for the Seventh Circuit, and respectfully show to this Honorable Court:

**OPINION BELOW**

The opinion of the United States Circuit Court of Appeals for the Seventh Circuit appears in the record at

pages 59 to 68 and is not yet reported. There was a dissenting opinion by Judge Lindley (R. 65).

### JURISDICTION

The United States Circuit Court of Appeals for the Seventh Circuit affirmed the District Court's judgment for respondent on June 28, 1943 (R. 68). Petitioners filed a timely petition for rehearing (R. 69), which was denied on August 9, 1943 (R. 105). This court has jurisdiction under Sec. 240(a) of the Judicial Code as amended, 28 U.S.C.A. Sec. 347(a).

### QUESTIONS PRESENTED

1. Whether, under an Illinois statute prohibiting exercise of a power of sale by a real estate mortgagee and limiting the method of foreclosure to a judicial proceeding, and under Illinois decisions holding that a mortgagee who, after taking from the mortgagee an instrument in form a deed, conveys by warranty deed to a stranger, extinguishes the debt by merger, an Illinois mortgagee who did not foreclose the mortgage, but who, to avoid foreclosure, took a deed from the mortgagors' grantee and thereafter conveyed the property by warranty deed to a stranger, was entitled to a deficiency judgment against the mortgagors.

2. Whether the mortgagee's conveying by warranty deed and cutting off the right of redemption conferred upon the mortgagors by an Illinois statute precluded recovery of a deficiency (assuming that because of a no-merger agreement between the mortgagee and the mortgagors' grantee, the mortgage was kept alive).

3. Whether an extension of time by the mortgagee to the mortgagors' grantee without the knowledge or consent of the mortgagors released the mortgagors to the extent of the value of the mortgaged real estate at the time of the extension (the Illinois rule being that the debt is so extinguished), which value, as shown by the only evidence thereon in the record, exceeded the debt; and whether this defense was available to the mortgagors who did not plead it in a suit in Indiana, the rule as established by the Indiana Supreme Court being that a special defense is available, although not pleaded, if the facts on which it is based appear, or whether the Federal Rules of Civil Procedure made such defense unavailable because not pleaded.

#### STATEMENT

Respondent enforced in the court below the alleged personal liability of petitioners under a promissory note and mortgage on Illinois real estate executed, delivered and payable in Illinois (R. 23-29, 68).

At the time the mortgage was executed, petitioners were residents of Illinois but thereafter they moved to Indiana, and, the mortgage not then being in default in any respect, they conveyed the mortgaged real estate to Hall-Hottel Company, Inc., of Indianapolis, by warranty deed subject to the mortgage (R. 23-26). When the next installment of the mortgage became due and unpaid, respondent requested payment thereof from said Hall-Hottel Company. (R. 30.) By reason of non-payment, the entire mortgage became due (R. 24).

Thereafter, following preliminary communications, respondent wrote said company as follows (R. 25, 32):

August 22, 1939.

Hall-Hottel Co., Inc.,  
129 E. Market St.,  
Indianapolis, Indiana.

Gentlemen:

Pursuant to my telephone conversation with Mr. Hall today and in reply to his letter of August 19, I enclose form of Quit-Claim Deed to the LeTourneau house in Peoria, together with a covering Agreement to be signed by James W. Luke, the Grantee in the Deed, and by the Bank. Luke is an officer of the Bank and is not a prospective purchaser of the house. The purpose of the covering Agreement is to avoid foreclosure and to give you a reasonable opportunity to sell the place and get something out of it for yourselves; the idea being that until noon of October 31, 1939, you can pay us off and make any disposition of the house you see fit, and may put it on the market at your own price. After that date, we are to be free to make any sale we can. I will add, however, that until we succeed in selling it we will be glad to have you take it off our hands for the amount of the mortgage.

I did not discuss terms with you and do not know if this will meet with your approval, but at least it will give us a start.

The first half of the current taxes was due June 1st and is unpaid. The second half will be due September 1st. To avoid building up penalties, I am having the Bank pay these taxes.

In order to protect ourselves, I am sending LeTourneau notice that we have declared the mortgage due for non-payment of interest and taxes, and I enclose a copy of that notice for you.

Yours truly,

Encs.

(Signed) Gerald H. Page.

Thereafter respondent received from said company the quit-claim deed referred to in said letter, and affixed to said deed United States documentary stamps in the amount of \$8.50 and caused it to be recorded (R. 25-26). On the same day Luke, respondent's officer and nominee, and his wife executed a quit-claim deed to respondent, which was recorded when respondent sold the mortgaged property as hereafter set forth. United States documentary stamps in the amount of 55¢ were affixed thereto (R. 26, 35-36).

At the time the deed was delivered by Hall-Hottel Company, respondent and said Luke executed the following agreement to that company (R. 26, 34-35):

Hall-Hottel Co., Inc.,  
Indianapolis, Indiana.

We acknowledge receipt of Quit-Claim Deed from you to James W. Luke, our Nominee, conveying the following premises:

Lots Four (4) and Five (5) in the Subdivision of Part of Lots one (1) and Two (2), Range One (1) in Moss' Addition to the City of Peoria, County of Peoria, State of Illinois.

In consideration of this conveyance, the undersigned agree that to and including noon of October 31, 1939, it will not sell or convey these premises except with your written consent and that until that time it will convey these premises to any person you designate upon payment in full to this Bank of all sums owing to it under its mortgage on the premises, recorded in Book 522, Page 413, Recorder's Office, Peoria County, Illinois.

This Bank may take possession of the premises at once subject to the terms of this Agreement.

It is understood that the delivery of this Quit-Claim Deed is not intended by either party, nor by

this Bank, to constitute or effect a merger of the above mentioned mortgage on the premises.

James W. Luke, (Seal)  
James W. Luke.

Signed Aug. 29-1939

Commercial Merchants National Bank  
and Trust Company of Peoria,

By George L. Luthy,  
President.

Respondent went into possession of said real estate, managed it at a substantial deficit and finally sold and conveyed it to a stranger by warranty deed which contained no reference to the mortgage (R. 26-28, 37, 38). Before conveying it, respondent brought this action against petitioners in the District Court for the Southern District of Indiana, and after the conveyance that court rendered a deficiency judgment measured by the principal of the note plus interest, attorneys' fees and respondent's operating deficit, minus what the court found the value of the property to be at the time of the conveyance by respondent (R. 29, 46). Respondent never foreclosed its mortgage.

#### SPECIFICATION OF ERROR

The Circuit Court of Appeals erred in affirming the judgment of the District Court in favor of respondent.

#### REASONS FOR GRANTING THE WRIT

1. The lower court has decided important questions of local law in a manner which is in conflict with applicable Illinois statutes and decisions.

The decision below that an Illinois mortgagee may take a deed from the mortgagor's grantee, simultaneously stipulating that no merger is intended, thereafter without foreclosure convey by warranty deed to a stranger and still recover a deficiency judgment against the mortgagor who

was not a party to the dealings between his grantee and the mortgagee is contrary to Illinois law, and so far as we have found, to the law of all other states in which judicial foreclosure is the only method by which a mortgagee, unless he acquires the fee by merger, can perfect his title.

The question of petitioners' liability is, of course, governed by Illinois law, as the note and mortgage were executed and payable in that state, and the real estate was there.

The rule is well-settled in Illinois that if there is a merger the debt is extinguished.<sup>1</sup>

Respondent's position heretofore has been that by the no-merger clause in the so-called covering agreement, the mortgage and debt were kept alive but that respondent had the power, as a result of its transaction with Hall-Hottel Company, to sell the mortgaged real estate. The majority of the Circuit Court of Appeals adopted that position but were of the opinion that a partial merger occurred when respondent conveyed the real estate by warranty deed. Respondent's position runs squarely afoul of an Illinois statute prohibiting a mortgagee's exercise of a power of sale and limiting the method of foreclosure to a judicial proceeding.<sup>2</sup>

<sup>1</sup> *Kessler v. Aller*, 287 Ill. App. 606, 5 N. E. 2d 761; *Weiner v. Heinz*, 17 Ill. 259, 262; *Belleville Savings Bank v. Reis*, 136 Ill. 242, 26 N. E. 646, 647.

<sup>2</sup> L. 1879, page 211; Chap. 95, Sec. 23, Ill. Rev. Stats:

"No real estate within this state shall be sold by virtue of any power of sale contained in any mortgage, trust deed or other conveyance in the nature of a mortgage, executed after the taking effect of this act; but all such mortgages, trust deeds or other conveyances in the nature of a mortgage shall only be foreclosed in the manner provided for foreclosing mortgages containing no power of sale; and no real estate shall be sold to satisfy any such mortgage, trust deed or other conveyance in the nature of a mortgage except in pursuance of a judgment or decree of a court of competent jurisdiction."

Petitioners have at all times agreed that respondent had the right to sell the property, but in the light of said statute such right was exercisable by respondent necessarily as the holder of the fee simple title and not as mortgagee. If the respondent acquired the fee, there was a merger. *Forthman v. Deters*, 206 Ill. 159, 69 N. E. 97, shows clearly that if the mortgagee becomes vested with the fee or "entire" (page 172) title by deed there is a merger, but that if there is not a merger the legal and equitable titles remain separate from each other. In other words if there is no merger a mortgagee of Illinois real estate continues to be such until he forecloses.<sup>3</sup>

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<sup>3</sup> In *Bearss v. Ford*, 108 Ill. 16, a mortgagor, to avoid a threatened foreclosure, conveyed the mortgaged premises to the mortgagee by a quitclaim deed containing a provision that if he should pay a certain sum representing the amount of the debt with interest and back taxes within one year, with interest thereon, the grantee should reconvey the premises to him. Subsequently, the mortgagee sued to foreclose and with respect to the question of the legal effect of the deed from the mortgagor, the court said (p. 25): "The most satisfactory, and as a general rule the controlling, test in cases of this kind is, does the giving of the new instrument operate as a satisfaction or extinguishment of the mortgage indebtedness? If it does not, such new instrument will be treated as an additional security for the debt,—or, in other words, as an additional mortgage; but if otherwise, it will be regarded as a sale and conveyance of the equity of redemption with an agreement for repurchase."

\* \* \*

Further the court stated (p. 26): "The parties may have intended, and doubtless did intend, that if the premises were not redeemed before the first of July, 1879, it (the instrument in question) should then become so (an absolute deed) in order to avoid the expenses of a foreclosure. But it is evident that the parties cannot, by mere agreement, change the law of the land. \* \* \* Every deed or other instrument takes effect from its delivery and its character thereby becomes at once fixed. It cannot, after such delivery, be one thing today and another tomorrow. If a mortgage when delivered, it continues to be such until the right of redemption is barred by some of the modes recognized by law. Hence, nothing is more firmly established in the law of mortgages than that it is not competent for the parties, even by express stipulation, to cut off the right of redemption, and to permit them to make such an instrument an absolute deed upon some future con-

The view of the majority of the Circuit Court of Appeals that two years after the deed to respondent there was a partial merger is untenable, because under well-settled Illinois law the intention of respondent and Hall-Hottel Company at the time of their transaction controlled with respect to the true nature of the instrument which that company delivered to respondent. It could not have been mortgaged temporarily and upon the happening of a future contingency (respondent's finding of buyer at a price acceptable to respondent and with which petitioners had nothing to do) become a deed or partly a deed.<sup>4</sup>

Not only did respondent say, in effect, to Hall-Hottel Company that it desired to obtain full title without foreclosure, and that it was to be free to sell after October 31, 1939, but under Illinois decisions respondent's sale and conveyance by warranty deed after the agreed date showed a clear intention to transfer the fee simple title acquired necessarily by merger, which extinguished the debt.<sup>5</sup>

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tingency, would simply be cutting off the right of redemption, which \* \* \* cannot be done." (Emphasis ours.)

See also *Kelly v. Lehman*, 297 Ill. 33, 130 N. E. 375; *Kulik v. Kapusta*, 303 Ill. 208, 135 N. E. 402.

<sup>4</sup> *Bearss v. Ford*, *supra* Note 3; *Bane v. Pritchett*, 223 Ill. App. 617; *Williams v. Griffith*, 310 Ill. App. 574, 35 N. E. 2d 95.

<sup>5</sup> In *Novak v. Kruse*, 288 Ill. 363, 123 N. E. 519, 520-521, the mortgagee took a quit-claim deed from the mortgagor. After default the mortgagee had its deed recorded, took possession of the property, managed it for two years and conveyed it by warranty deed. It was held that the mortgage debt had been extinguished. Said the court (p. 520):

"By its deed the association covenanted that the property was clear and free from all encumbrances \* \* \*. We are convinced that the quit-claim deed was given by Ayres to the association, with authority to record the same and take title to the property on default of payments under the bond, and that when the quit-claim deed was recorded the title passed to the association. \* \* \* This is further borne out by the fact that the association for two years rented the premises, insured the buildings thereon, and paid the taxes, all in its own name, and it recited in its warranty deed to James Novak and in the resolution of its board of directors that it owned the premises. This being the clear

The proper legal result of the transaction is cogently stated by Judge Lindley in the dissenting opinion as follows:

"The right of redemption can be barred only by the method recognized by law. (*Kelly v. Lehman*, 297 Ill. 33; *Kulik v. Kapusta*, 303 Ill. 208; *Bane v. Pritchett*, 223 Ill. App. 617.) So when the mortgagee received a quit-claim deed from the holder of the equity of redemption, it did one of two things, (1), it took the title as additional security, (as it insists), and, if so, its title was still only that of a mortgagee, or (2), it took the fee and merged its mortgage therein and then and thereby put an end to its lien.

"But if it was its intention to achieve (1), i. e., remain a mortgagee, it could later perfect its title and wipe out the equity of redemption only by foreclosure,—for, on its own admission, its title was still that of a mortgagee, and its rights and remedies were only those fixed by the Illinois statute.

\* \* \* \* \*

"\* \* \* The purpose of this statute is to prevent sales of the equity of redemption and no scheme or device to evade the statute or circumvent it by provision depriving the debtor of his equity of

understanding of the parties to the deed, such must be the effect of the instrument."

The fact that in the case at bar the quit-claim deed to respondent was not recorded until respondent sold the property and executed its warranty deed to the purchaser, instead of being recorded, as in *Novak v. Kruse*, before respondent took possession and managed the property, is unimportant. The vital element was respondent's desire to obtain full title without foreclosure.

In *Lyman v. Gedney*, 114 Ill. 388, 406, 29 N. E. 282, 286, the court said:

"Objection is urged that a mortgage made by Broom field to Sizer March 2, 1842, is not shown to have been satisfied; but it is proved that Broomfield, after executing the mortgage, conveyed the fee to Sizer, the mortgagee, and W. H. Cushman, and that Sizer subsequently conveyed to Cushman. That extinguished the mortgage."

See also *Weiner v. Heinz*, *supra*, Note 1; *Shinn v. Frederick*, 56 Ill. 439; *Tabero v. Stutekowski*, 286 Ill. App. 225, 232, 3 N. E. 2d 115, 118, 119.

redemption will be upheld. *DeVoigne v. Chicago T. & T. Co.*, 304 Ill. 177; *Knox v. Hunter*, 150 Ill. App. 392. The equity of redemption exists by virtue of the statute, not by virtue of the mortgage. *Strause v. Dutch*, 250 Ill. 326; *Chicago Sav. Bank v. Coleman*, 283 Ill. 611. So if the quit-claim deed was taken, not in satisfaction of the debt, but, as plaintiff contends, as additional security, plaintiff's rights were the same after receiving the deed as before. It still had only a conveyance in the nature of a mortgage; its title was still only security for the debt and could be perfected, under the quoted statute, only by foreclosure in a court of competent jurisdiction.

"But this it never did; rather, it treated its title not as an unforcedclosed mortgage, but as the fee simple. It even conveyed the property with warranty of such title. Consequently it must fall into alternative (2) above, for by its actions, it has unequivocally and emphatically dealt with the property as its undisputed unincumbered owner. It must be held legally to have done what it professes not to have done but what it, by its acts, has actually done, when those acts are considered and construed in the light of the Illinois statute,—accepted the title in fee, merged its mortgage in such fee and forever discharged it. *Bradley v. Lightcap*, 202 Ill. 154, rev'd on other grounds, 195 U. S. 5; *Forthman v. Deters*, 206 Ill. 159. This is only another instance of proof of the wisdom of the adage that one may not eat his cake and have it too."

Moreover under the applicable Internal Revenue Act documentary stamps which respondent attached were not required unless vesting of full title in respondent and release of the debt were intended.<sup>6</sup>

<sup>6</sup> 53 Stat. 425, as amended, c. 247, Title I, sec. 1, 53 Stat. 862; 26 U. S. C. A. sec. 3482. See *Railroad etc. Assn. v. United States*, 135 F (2d) 290, 292 (advance sheet).

The no-merger agreement was intended and in the light of the record could have been intended only as a protection against intervening liens.<sup>7</sup>

2. The decision of the majority of the Circuit Court of Appeals conflicts with the Illinois statute giving petitioners, upon enforcement of their personal liability as mortgagors (assuming such liability was not terminated by merger) a right to redeem<sup>8</sup> and conflicts with *Brine v. Hartford Fire Insurance Company*, 96 U. S. 627, 24 L.Ed. 858, and *Swift v. Smith*, 102 U. S. 442, 26 L.Ed. 193. Such right of redemption was cut off by respondent's conveyance by warranty deed to a stranger, and the debt was thereby extinguished.<sup>9</sup> The majority apparently recognized this but took the view that petitioners had no right of redemption because they had conveyed their equity to Hall-Hottel Company.<sup>10</sup> This view is clearly erroneous.<sup>11</sup>

<sup>7</sup> *Woodward v. McCollum*, 16 N. Dak. 42, 111 N. W. 623; *Railroad etc. Assn. v. United States*, *supra*, Note 6.

<sup>8</sup> Chap. 77, Sec. 18, Ill. Rev. Stats., provides: "Any defendant \* \* \* may \* \* \* within twelve months from said sale, redeem the real estate so sold by paying to the purchaser thereof \* \* \* or to the sheriff or master in chancery \* \* \* the sum of money for which the premises were sold or bid off," with 6% interest, etc.

<sup>9</sup> In 3 Jones on Mortgages, 8th edition, sec. 1582, p. 16, it is stated:

"A mortgagee will lose his right to sue the mortgagor for the debt by so dealing with the mortgaged property as to put it out of his power to restore the property on a tender of full payment."

<sup>10</sup> The majority say (R. 63): "It should be noted that defendants had parted with their title to the real estate. They had no equity of redemption"; and again (R. 64): "Defendants had parted with all their interest in this real estate. They had sold their equity of redemption."

<sup>11</sup> In 37 Am. Jur., sec. 829, page 215, it is stated: "The statutory right of redemption from a sale of land under mortgage foreclosure proceedings exist in favor of the mortgagor and those claiming under him."

Moreover it is plain that petitioners would have been necessary parties to a foreclosure suit in Illinois if a personal judgment was to be sought against them. *Brockway v. McClun*, 243 Ill. 196, 90 N. E. 374, 375; *Coney v. Winchell*, 116 U. S. 227, 29 L. Ed. 610.

3. The decision below conflicts with *Kazunas v. Wright*, 286 Ill. App. 554, 4 N. E. 2d 118; *Lillie v. McFarlin*, 304 Ill. App. 27, 25 N. E. 2d 896; *Paxton Realty Company v. Peaker*, 212 Ind. 480, 490-491, 9 N. E. 2d 96, 100; and hence with *Erie R. Co. v. Tompkins*, 304 U. S. 69, 82 L.Ed. 1118.

*Kazunas v. Wright* holds that a mortgagee's extending to the mortgagor's grantee time for the payment of the debt without the knowledge or consent of the mortgagor releases the mortgagor from personal liability to the extent of the value of the mortgaged real estate at the time of the extension. *Lillie v. McFarlin* establishes that the test of whether the mortgagor is released is whether the mortgagee under his arrangement with the mortgagor's grantee is obligated to forbear.

In the case at bar the District Court found (R. 24) that as a result of the non-payment of the installment due August 1, 1939, the mortgage debt became due. Subsequently respondent mailed notices to that effect but agreed with Hall-Hottel Company that until October 31, 1939 "you can pay us off." (R. 32). Under *Lillie v. McFarlin* respondent was obligated to forbear from commencing any action to collect the debt, although due, or to foreclose until the expiration of the agreed time. Petitioners were thereby discharged because the only evidence in the record concerning the value of the mortgaged premises at that time shows that such value exceeded the debt.<sup>12</sup>

<sup>12</sup> The total revenue stamps affixed by respondent showed a consideration of \$9,000. See Note 6, *supra*. In *Williams v. Griffith*, *supra*, Note 4, the revenue stamps placed on a deed to a mortgagee were held to be evidence of the presumed consideration of the amount of money represented by the stamps. The Illinois Appellate Court said (35 N. E. 2d 96):

"The deed was in the usual statutory form and for a stated consideration of \$1. It bore Internal Revenue stamps in the sum of \$2.50, indicating a presumed consideration of \$2,500 (the indebtedness at the time was approximately in that sum)."

The lower court held that the defense of release of petitioners by extension of time was not available to them because it was not specially pleaded, citing *State v. Traylor*, 77 Ind. App. 419, 132 N. E. 608. In that case, however, the court was dealing with a contention that there had been a release by "extension of time and novation" (page 423), and indicated that such a defense must be specially pleaded. There was no novation in the instant case, as the mortgaged property, at all times before respondent acquired full title thereto, constituted the primary fund for the payment of the debt. But even if the rule that an affirmative defense must be specially pleaded in order to be available is applicable to the defense of a release of a surety by extension of time without his consent, such rule is not applicable here because the Indiana Supreme Court has held that where the evidence showing the facts constituting an affirmative defense has been introduced by either party such evidence may be fully considered by the court in connection with such defense.<sup>13</sup>

Respondent has contended heretofore that "the Federal rules, and not the Indiana Supreme Court, must govern the effect of failure to plead," but Rule 8(c) of the Rules of Civil Procedure, upon which respondent has relied, "governs only the manner of pleading." *Palmer v. Hoffman*, 87 L.Ed. 427, 432 (advance sheet). The availability

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<sup>13</sup> *Paxton Realty Corporation v. Peaker*, *supra* page 13. There the Court said:

"Conceding, as contended for by appellant, that the rescission of a contract is an affirmative defense, it must also be conceded that, under a general denial, if there are no objections, evidence may be introduced as to the rescission of a contract. The evidence is not in the record and the presumption must be that the evidence of cancellation and surrender of the lease and the acceptance thereof by the lessor was either given by the appellant in its own testimony or was given by the appellee without objection by the appellant. In either event the court would be justified in making the finding it did."

of an unpleaded special defense, the facts constituting which fully appear, like the question involved in the *Palmer* case, namely, the burden of establishing contributory negligence, is a question of local law "which federal courts in diversity of citizenship cases \* \* \* must apply." At all events, the federal rules do not purport to cover the effect of failure to plead. The general rule of availability of a special defense, where the facts constituting it are shown by respondent, although narrower than the Indiana rule, is broad enough to make the defense available here.<sup>14</sup>

Petitioners earnestly submit that their petition should be granted.

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<sup>14</sup> Where the facts constituting an affirmative defense appear from plaintiff's pleading or proof, the defense is available although not pleaded, 41 Am. Jur. p. 371, sec. 118, and cases cited in Note 7. Hence even under that statement of the rule the special defense is available in the instant case inasmuch as the facts showing the extension of time appeared upon respondent's proof of the arrangement with Hall-Hottel Company whereby that Company executed its quit-claim deed. Although not set forth in the record, a request for the admission of the genuineness of most of the exhibits, including those establishing said arrangement, was served by respondent upon petitioners pursuant to Rule 36 of the Rules of Civil Procedure. Those exhibits were included in a stipulation of facts and are referred to, or incorporated in, the special findings of fact, and the record shows that in a supplemental stipulation respondent agreed to submission of the cause "on the record \* \* \*, together with this stipulation" (R. 39.)

Respectfully submitted,

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Attorneys for Petitioners.